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Agricultural Transportation Challenges for the 21st Century

Future Regulatory Oversight of U.S. Railroads

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Issue

Economic regulation of U.S. railroads is at a crossroad. The increasing consolidation of the U.S. rail industry and the recent railroad service failures have led some to argue that a lack of competition in the industry is the problem and that increased regulatory oversight over railroads is needed to protect shippers. Yet, others claim that the recent western railroad problems were due to one-time merger effects or to long-term capacity constraints rather than to a lack of competition and that railroad regulatory constraints should be kept to a minimum to allow railroads to earn the profits they need to upgrade their infrastructure. While that debate continues, the STB has begun working towards a new regulatory framework based on a recent review of these issues. In addition, legislation increasing Government regulation over U.S. railroads is being considered in the U.S. Congress.

Background

After several modest attempts to revitalize the industry failed, the Carter Administration, as part of a broader deregulatory strategy, recommended reforming Federal regulatory policy over railroads. The resulting legislation, *The Staggers Rail Act of 1980,* gave railroads greater freedom to market their services and to set rates. Railroads, for example, were allowed to enter into contracts with shippers. In addition, the procedures governing the abandonment of uneconomical lines were liberalized and, through various regulatory rulings, the Interstate Commerce Commission encouraged the creation of new short line railroads to operate over many of the light-density rail lines that might otherwise have been abandoned.

Because of the *Staggers Act* and favorable work rule changes, the Class I carriers were able to rehabilitate the U.S. rail system.. Today's railroads bear little resemblance to carriers of the 1970s. Class I railroads currently are "wholesalers," providing long-haul, large volume transportation services over a smaller network, rather than, as they once were, "retailers" of transportation services to a wide variety of smaller shippers. Today, for instance, Class I railroads are content to leave the grain gathering function to trucks or to regional and short line railroads, rather than attempt to perform that function themselves. These and other changes in operating philosophy have allowed U.S. railroads to rationalize their systems, to shed expensive and underutilized assets, and to increase their investments in new, more productive assets. A "virtuous cycle" has ensued, which has enabled railroads to lower rates and improve service, while simultaneously increasing profits and capital expenditures.

Unfortunately, while railroads have increased their competitiveness relative to other modes of transportation, the amount of intramodal competition (rail vs. rail) has fallen in recent years. Driven by the desire to exploit economies from larger railroad systems, recent railroad mergers have left the nation with just four dominant carriers; Union Pacific and Burlington Northern Santa Fe in the western United States, CSX Transportation and Norfolk Southern in the eastern United States.

Greater concentration within the U.S. industry increased the number of shippers dependent upon just one or two railroads that would be interested in legislative and regulatory safeguards to prevent potential market power abuse by railroads. This diminishing degree of intramodal rail competition also resulted in a loss of product and geographic competition in key agricultural markets. More fundamentally, the increasing concentration of the U.S. railroad industry reinforced the complaints of many shippers that the industry suffered from a fundamental lack of competition. Some shippers have also attributed the recent service failures of the western railroads to a fundamental lack of competition in the industry.

Implications

Among shippers, and the public at large, there is a considerable and growing anti-railroad sentiment. It is clear that important segments of the public have lost confidence in the current system of oversight and something must be done to restore that confidence, if only to prevent a return to wholesale regulation of the rail industry.

Recent actions by the STB may help restore public confidence in rail regulation. Congress, which this year must reauthorize the STB, is considering legislation that would enhance the STB's powers and provide it with additional guidance in exercising those powers. Whether additional Government oversight over railroad operations will help avoid service disruptions depends upon the fundamental cause of those service disruptions; i.e., whether they resulted from a lack of competition in the industry, were one-time merger effects resulting from a combination of the operations of two dissimilar railroads, or are early indicators of long-term capacity problems in the U.S. rail industry. Rail regulation is a significant long-term issue because, in a sense, the treatment of the patient depends upon an accurate diagnosis of the illness. If, for example, the recent service disruptions were the result of long-term capacity problems, onerous regulations could limit the ability of U.S. railroads to earn the revenue to finance needed infrastructure upgrades. But, if recent mergers have given railroads inordinate market power over shippers then weak regulation will not be effective.

In the long term, the railroad service failures of 1997-98 will likely be seen as the start of a new chapter in rail regulation. While that chapter has yet to be written, some attempt will undoubtedly be made to increase the amount of Federal regulatory oversight over the U.S. railroad industry in order to promote greater inter-railroad competition and recognition of shipper interests. Whether such regulation will address the fundamental causes of the recent western railroad service failures remains to be seen.

Information Sources

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